

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

CC:PSI:B02

PLR-120641-07

Date:

November 28, 2007

Legend

X =

Trust 1 =

Trust 2 =

Trust 3 =

State =

D1 =

D2 =

D3 =

D4 =

Dear

This responds to a letter dated April 26, 2007, submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

The information submitted states that X was incorporated under the laws of State on D1. The shareholders of X intended X to be an S corporation effective D2, and a Form 2553, Election by a Small Business Corporation, was timely filed for X. However, Trust 1, Trust 2, and Trust 3 (collectively "Trusts"), shareholders of X, were intended to have been electing small business trusts (ESBTs) under § 1361(e) effective D2, but no ESBT election was properly filed by the respective trustees of Trusts. On D3, Trust 2 and Trust 3 terminated and distributed all their shares of X to the individual beneficiary of each respective trust.

X represents that the failure to file the ESBT election for Trusts was not motivated by tax avoidance or retroactive tax planning. X and its shareholders have agreed to make any adjustments the Commissioner may require, consistent with the treatment of X as an S corporation.

Section 1361(a)(1) of the Code defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that, for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder. Section 1361(c)(2)(A)(v) provides that an ESBT may be a shareholder.

Section 1361(e) defines an ESBT. Section 1361(e)(1)(A) provides that, except as provided in § 1361(e)(2)(B), an ESBT means any trust if (i) such trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2), (3), (4), or (5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a PCB, (ii) no interest in such trust was acquired by purchase, and (iii) no election under § 1361(e) applies to such trust. Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) of the Income Tax Regulations provides that the trustee of the ESBT must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-(m)(2)(ii).

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was not effective for the taxable year for which it was made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the event resulting in the ineffectiveness, steps were taken (A) so that the corporation is a small business corporation, or (B) to acquire the required shareholder consents, and (4) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Based on the information submitted and the representations made, we conclude that any S corporation election by X intended to be effective D2 would have been ineffective because of the failure of Trusts to file ESBT elections, and this ineffectiveness was inadvertent with the meaning of § 1362(f).

We hold that, pursuant to the provisions of § 1362(f), X will be treated as an S corporation from D4 and thereafter, provided X was otherwise eligible to make an S corporation election and provided that any such election would not have otherwise been terminated under § 1361(d). Trust 1 will be treated as an ESBT from D4 and thereafter. The shareholders of X must include their pro-rata share of the separately stated and nonseparately computed items of X as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

This ruling is contingent upon (1) the trustee of Trust 1 filing an ESBT election effective D4 with the appropriate service center and (2) Trust 1 filing amended returns for taxable years beginning D4 and thereafter consistent with the treatment of Trust 1 as an ESBT. The ESBT election and the amended returns must be filed within 60 days following the date of this letter and a copy of this letter should be attached to any such elections or returns.

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed on whether X was or otherwise eligible to be treated as an S corporation or whether Trusts are eligible to be ESBTs.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being forwarded to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for section 6110 purposes

cc: